ST 06-15
Tax Type: Sales Tax
Issue: Sales v. Service Issues
Reasonable Cause on Application of Penalties

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	**)**	
	)	**Docket # 00-ST-0000**
v.	**)**	**IBT # 0000-0000**
	)	**NTL # 00-0000000000000**
	)	**NTL # 00-0000000000000**
JANE DOE d/b/a ABC AMUSEMENTS	**)**	**NTL # 00-0000000000000**
	)	**Assmt # 00 0000000000000**
Taxpayer	**)**	**Assmt # 00 0000000000000**

RECOMMENDATION FOR DISPOSITION

Appearances: Kent Steinkamp, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Stephen R. Wigginton of Weilmuenster & Wigginton, P.C. for *Jane Doe* d/b/a *ABC* Amusements.

Synopsis:

The Department of Revenue ("Department") conducted an audit of *Jane Doe* d/b/a *ABC* Amusements ("taxpayer") for the time period of April 1999 through December 2002. After completing the audit, the Department issued three Notices of Tax Liability ("NTL's") to the taxpayer that assessed additional retailers' occupation tax ("ROT"). The taxpayer did not timely protest the Department's determination but subsequently requested a discretionary hearing, which was granted. While this case was pending, in

March and April of 2005 the Department issued two Notices of Assessment for the time period of January 2003 through December 2004. The taxpayer requested a discretionary hearing for these two assessments. The request was granted and the assessments were consolidated with the present case. The taxpayer operates a carnival business, and she claims that her sales of food at her carnival are exempt from ROT because her occupation is a service occupation under the Service Occupation Tax Act ("SOTA") (35 ILCS 115/1 *et seq*.) rather than a retail occupation under the Retailers' Occupation Tax Act ("ROTA") (35 ILCS 120/1 *et seq*.). She also claims that in the event that it is found that her sales are subject to ROT, the penalties should be abated due to reasonable cause. After reviewing the record, it is recommended that this matter be resolved in favor of the Department.

FINDINGS OF FACT:

1. The taxpayer and her husband, *John*, are sole proprietors of a carnival business known as *ABC* Amusements. (Tr. pp. 49-50)
2. The taxpayer and her husband own three rides and a ½ interest in three other rides. They also own one game known as a skeeball concession. In addition, they own a corndog concession, a diner, ½ interest in a funnel cake trailer, and ½ interest in an ice cream trailer. The other ½ interests belong to either their daughter or son. (Taxpayer Ex. #3; Tr. pp. 49-50)
3. *John*'s parents started *ABC* Amusements in 1958. In 1972, the taxpayer and *John* began working for *John*'s parents, and they eventually purchased their first ride. *John*'s mother and his two brothers still work in the business. (Tr. pp. 51-53)

4. The taxpayer and her husband purchased their first food trailer in 1980. (Tr. p. 53)
5. The entire carnival currently has 16 rides, approximately 30 games, and 5 food trailers. (Tr. p. 52)
6. People who attend the carnival may purchase food without going on the rides. (Tr. pp. 89-90)
7. Sometimes the carnival is operated in the parking lot of a shopping center, and customers will stop and get food and leave without riding on the rides. (Tr. pp. 63-64)
8. In 1990, the carnival was operating in Anywhere, Illinois, and an auditor visited the business. After the visit, the taxpayer registered the business with the Department and obtained a sales tax number. The taxpayer registered the business only under her name. (Tr. pp. 54-55)
9. In 2003, the Department began an audit of the taxpayer's business for the period of April 1999 through December 2002. (Tr. p. 8)
10. For the years 1999 and 2000, the taxpayer did not provide the auditor with sales records, so the auditor used the taxpayer's income tax records to estimate the ROT liability. (Tr. pp. 10-11)
11. For the audit period, the auditor determined that the taxpayer owed ROT in the amount of $55,695 for taxable sales that were not reported. The auditor also found that the taxpayer owed use tax of $990 for tax not paid on purchases of capital assets, and $206 for tax not paid on purchases of consumable supplies. On

April 28, 2004, the Department issued three NTL's to the taxpayer for the additional tax and late filing penalties. (Dept. Ex. #1, 3; Tr. pp. 17-18)

12. On March 31, 2005, the Department issued a Notice of Assessment to the taxpayer showing tax due of $13,810 for the year 2003. On April 14, 2005, the Department issued a Notice of Assessment to the taxpayer showing tax due of $7,894 for the year 2004. Both Notices included penalties for late filing and late payment. (Dept. Ex. #1)
13. The taxpayer's accountant, XXXXXX, has been preparing tax returns and providing tax advice to the taxpayer since 1980. (Tr. p. 76)
14. In 1990, the taxpayer's accountant advised the taxpayer to register with the Department to get a sales tax number. (Tr. p. 54)

CONCLUSIONS OF LAW:

A retailers' occupation tax is imposed upon persons engaged in the business of selling at retail tangible personal property. 35 ILCS 120/2. A "sale at retail" is defined as "any transfer of the ownership of or title to tangible personal property to a purchaser, for the purpose of use or consumption, and not for the purpose of resale in any form as tangible personal property to the extent not first subjected to a use for which it was purchased, for a valuable consideration." 35 ILCS 120/1. The tax is computed based on the gross receipts from the sales of tangible personal property made in the course of business. 35 ILCS 120/2-10.

A service occupation tax is imposed "upon all persons engaged in the business of making sales of service (referred to as 'servicemen') on all tangible personal property transferred as an incident of a sale of service * * *." 35 ILCS 115/3. A "sale of service"

is defined as any transaction other than a retail sale or a sale for the purpose of resale. 35 ILCS 115/2. The tax is computed as a percentage of the cost price to the serviceman of the tangible personal property. 35 ILCS 115/3-10. The service occupation tax ("SOT") places service providers in parity with retailers to the extent that they transfer tangible personal property as an incident to the sale of the service. Soho Club, Inc. v. Department of Revenue, 269 Ill. App. 3d 220, 229 (1st Dist. 1995). Only one occupation tax is imposed upon a particular item of commerce. *Id*.

As a general rule, ROT applies to all sales at retail unless the taxpayer produces evidence in the form of books and records to show that the sale is not subject to ROT. H.D., Ltd., v. Department of Revenue, 297 Ill. App. 3d 26, 34 (2nd Dist. 1998). Section 4 of the ROTA provides that the certified copy of the notice of tax liability issued by the Department "shall be prima facie proof of the correctness of the amount of tax due, as shown therein." 35 ILCS 120/4. Once the Department has established its *prima facie* case by submitting the notice into evidence, the burden shifts to the taxpayer to overcome this presumption of validity. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 832 (1st Dist. 1988). To prove its case, a taxpayer must present more than its testimony denying the accuracy of the Department's assessment. Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill. App. 3d 203, 217 (1st Dist. 1991). The taxpayer must present sufficient documentary evidence to support its claim. *Id*.

The taxpayer claims that she is exempt from ROT because she has a service occupation rather than a retail occupation. The taxpayer states that if a sale of service includes a relatively insignificant or incidental transfer of tangible personal property, then SOT will be assessed rather than ROT. (American Airlines, Inc. v. Department of

Revenue, 58 Ill. 2d 251 (1974)). The taxpayer also states that the distinctions between occupations taxable under the ROT and the SOT are often elusive and difficult to determine, and each determination ultimately rests upon its own facts.

The taxpayer argues that the sale of fair food is an insignificant and incidental transfer of property that requires an assessment of SOT and not ROT. The taxpayer asserts that the auditor admitted that she had not previously audited a carnival, but the taxpayer's accountant has been familiar with the carnival industry for years. According to the taxpayer's accountant, the taxpayer's predominant income activity is service, and the sale of food is merely incidental to the carnival services. The taxpayer maintains that food is part of the total carnival package. The taxpayer argues that she operates a service company that provides rides, games, food, music, and entertainment, and food is part of the entire business. The taxpayer states that the food trailers are always set up with the rides and are not set up alone. The taxpayer claims that the carnival can run without the food trailers, but the food trailers do not run without the carnival.

The Department argues that the taxpayer's food sales are significant and are not incidental to the carnival. The Department contends that the amount of revenue that the taxpayer received from the fool sales is significant and on average is more than 43% of the total revenue from 1999 through 2001. The Department claims that the transfer of property is incidental to the service if the customers relied on the service person's skill in performing the service and cites the following:

> When a customer contracts for the restoration of a motor vehicle's function and relies upon the experience and skill of the serviceman in the performance of this task, the serviceman is engaged in the sale of a service. If in the course of repair it becomes necessary to replace a part, and the serviceman chooses the part and installs it, its transfer is incidental to the service. The repairman is liable for the service occupation tax based

> upon the cost price of the item to him. On the other hand, when a customer purchases from a service station an item such as seat covers for his automobile and makes the selection and the sale does not obligate the seller to install them, then, even though the seller does install them, the transaction is a sale at retail, and taxable under the Retailers' Occupation Tax Act. Pierce v. Pacini, 127 Ill. App. 2d 1, 7 (1st Dist. 1970).

The Department notes that carnival operators do not have a special skill. Also, both the taxpayer and her accountant admitted during their testimony that the sale of the food is separate from the rides, and some people may attend the carnival and purchase food but not ride on the rides.

According to the Department, in order for SOT to apply rather than ROT, the carnival business must be engaged in a service that requires a special skill for which a customer contracts. The Department asserts that no claim to that effect has been made in this case, and no one goes to the carnival sites because they are attracted to the particular skills of the ride attendants. The Department claims that the provision of rides and the provision of food items are separate activities, and they do not even have to be owned by the same business.

In response, the taxpayer contends that the Department's reliance on Pierce, *supra,* is misplaced because that case involved the repair of a vehicle and did not involve a carnival. The taxpayer states that the regulations relied on by the court in Pierce concerned the repair of automobiles. In Pierce, the court cited the statute and stated that a serviceman is "any person who is engaged in the occupation of making sales of service." Pierce, 127 Ill. App. 2d at 8. The taxpayer states that there is no Illinois decision that has held that a carnival operation is not a service occupation.

The evidence presented in this case indicates that the taxpayer has failed to meet its burden of overcoming the Department's *prima facie* case that the sale of food items is

subject to ROT. The Illinois Supreme Court has noted that a standard has been developed to determine whether a business is a service or a retail occupation. The test is stated as follows:

> If the article sold has no value to the purchaser except as a result of services rendered by the vendor and the transfer of the article to the purchaser is an actual and necessary part of the service rendered, then the vendor is engaged in the business of rendering service and not in the business of selling at retail. If the article sold is the substance of the transaction and the service rendered is merely incidental to and an inseparable part of the transfer to the purchaser of the article sold, then the vendor is engaged in the business of selling at retail. [citations omitted] Colorcraft Corporation, Inc. v. Department of Revenue, 112 Ill. 2d 473 (1986).

Depending on the circumstances surrounding the contract for sale, it is possible for a single business person to be subject to both taxes, although not for the same transfer of tangible personal property. Hagerty v. General Motors Corporation, 14 Ill. App. 3d 33, 37 (1st Dist. 1973).

In the present case, the sale of the food items is a retail sale that is a separate and distinct transaction from the purchase of a ride. The food is the substance of the transaction, and the serving of the food is incidental to the transfer of the food. The test for a service occupation has not been met because the food has a value to the purchaser regardless of the services rendered, and the transfer of the food to the customers is not a necessary part of the completely separate services rendered by the ride-operators. The taxpayer admitted that customers may purchase food without riding on the rides.

The facts in the case of Dinner Theatre Associates, Ltd. v. Department of Revenue, 139 Ill. App. 3d 911 (3rd Dist. 1985) are noteworthy. In that case the taxpayer operated a dinner theatre, and the price of admission included both a buffet dinner and a theatrical production. The taxpayer argued that it should pay only SOT on the cost of its

raw food purchases and not pay ROT. The Department determined that ROT should be assessed based on the cost of meals served to the patrons, which the Department estimated was one-half of the admission price. The court upheld the Department's assessment and stated as follows:

> A taxpayer, however, may be involved in a taxable business of both selling goods at retail and in the furnishing of a service. That is the situation we have here. The record supports the Department's judgment that the [taxpayer] is engaged in two separable tax businesses and that one-half of the admission price is attributable to the meals served. Dinner Theatre, 139 Ill. App. 3d at 912.

The taxpayer in the present case is similarly involved in both the selling of goods at retail and in the furnishing of a service. The cost of the food to the customers is easier to determine than it was in Dinner Theatre, *supra*, because the purchase price for the food items is separate from the purchase price for a ride. Nothing in the record indicates that payment for a ride entitles the customer to any food, beverage, or other tangible personal property. The transfer of the food items and the rendition of services related to the rides are easily divisible in this case. Although the taxpayer claims that the food trailers do not run without the carnival, they can be operated without the carnival. The sale of the food items is a retail sale that is subject to ROT.

In addition, the taxpayer argues that the penalties should be abated because the taxpayer solely and reasonably relied upon the expertise and advice of her accountant in paying her taxes. The taxpayer contends that she went to her accountant whenever she had a tax question, and he would advise her as to how to proceed. She claims that she made every effort to determine her property liability in this case. The taxpayer maintains that she is not experienced, knowledgeable or educated in this area. In the taxpayer's view, this case is analogous to Rohrabaugh v. United States, 611 F. 2d 211 (7th Cir.

1979), where the court found that the taxpayer established reasonable cause for abating a late filing penalty. The taxpayer believes that she did everything that she could to make a good faith effort to determine her tax liability.

The Department argues that the facts in Rohrabaugh are not similar to the present case. The Department also contends that in the present case the taxpayer testified that since 1990 she was aware of her responsibility to pay Illinois sales tax on her food sales. The Department believes that the reason the taxpayer did not pay the tax was not because of her accountant's advice. The Department notes that her accountant's advice was contradictory because at one point he told her to get a sales tax registration number and to pay the ROT when a field auditor was there to collect it. At other times, he told her that SOT should apply. According to the Department, no reasonable person could assume that under these circumstances ROT should not be paid.

In response, the taxpayer asserts that she had no experience in the field of accounting and solely relied on her accountant. The taxpayer states that if she had as much experience and knowledge as the Department suggests, then she would not have allowed her accountant to let the statute of limitations expire on her claims for a refund of the ROT that she did pay. She maintains that she exercised ordinary business care and prudence by providing her accountant with all of the information that she received from the Department and followed his recommendations.

The late filing and late payment penalties were imposed pursuant to section 3-3 of the Uniform Penalty and Interest Act ("UPIA") (35 ILCS 735/3-1 *et seq*.). Section 3-8 of the UPIA provides a basis for the abatement of the section 3-3 penalties and states in part as follows:

> The penalties imposed under the provisions of Sections 3-3, 3-4, and 3-5 of this Act shall not apply if the taxpayer shows that his failure to file a return or pay tax at the required time was due to reasonable cause. Reasonable cause shall be determined in each situation in accordance with the rules and regulations promulgated by the Department. 35 ILCS 735/3-8.

The Department's regulations concerning reasonable cause provide as follows:

> b) The determination of whether a taxpayer acted with reasonable cause shall be made on a case by case basis taking into account all pertinent facts and circumstances. The most important factor to be considered in making a determination to abate a penalty will be the extent to which the taxpayer made a good faith effort to determine his proper tax liability and to file and pay his proper liability in a timely fashion.
>
> c) A taxpayer will be considered to have made a good faith effort to determine and file and pay his proper tax liability if he exercised ordinary business care and prudence in doing so. A determination of whether a taxpayer exercised ordinary business care and prudence is dependent upon the clarity of the law or its interpretation and the taxpayer's experience, knowledge, and education. Accordingly, reliance on the advice of a professional does not necessarily establish that a taxpayer exercised ordinary business care and prudence * * *. 86 Ill.Admin.Code §700.400(b), (c).

The taxpayer claims that she relied on the advice of her accountant, but her accountant's advice was not consistent. In 1990, her accountant advised her to register with the Department to get a sales tax number. (Tr. p. 54) During the 1990's, whenever one of the Department's field auditors would visit the taxpayer's business, her accountant advised her to pay the ROT. (Tr. pp. 56, 62, 72, 85) She would pay the tax only when an auditor would visit. (Tr. p. 59) Apparently during the same time period, the accountant advised the taxpayer that she was subject to SOT rather than ROT. (Tr. pp. 62, 76-77, 84)

The accountant testified that he told her to pay the ROT because she was receiving pressure in the field, and even though he did not agree with it, he was hoping to

get the money back by filing claims for refund. (Tr. pp. 85, 87) He stated that claims for refund had not been filed because the issue is still unresolved. (Tr. p. 86) He admitted, however, that he was aware that the statute of limitations had expired for filing claims for most of the tax paid. (Tr. p. 87)

The record does not indicate the type of education that the taxpayer has received other than that she has attended high school. (Tr. p. 51) She has been operating a carnival business for many years and clearly has experience in business matters. The taxpayer also admitted that she was aware that other vendors who operate only food trailers pay ROT on the sales of the food. (Tr. pp. 58-59) Although the taxpayer now claims that her business should be treated differently from those businesses because she also operates rides, she has not shown that she exercised ordinary business care and prudence to determine her proper tax liability. Even though she apparently thought she was subject to SOT, she continued to pay ROT only when an auditor would visit, and she never filed claims for refund. She also apparently did not keep sales records for the years 1999 and 2000 because she did not provide the auditor with the records and gave no explanation for not having them. Moreover, despite the fact that she was supposedly receiving conflicting information, she never made any effort to resolve the conflict, such as consulting another tax advisor. These facts do not establish reasonable cause for abating the penalties.

The Rohrabaugh case is distinguishable. In that case, the court abated the penalty for the late filing of a federal estate tax return. Among other things, the decision was based on the fact that the taxpayer had only a high school education, was inexperienced in business matters, and relied on a competent tax expert. The court also noted that the

type of tax has a bearing on determining ordinary business care and prudence, and the case might have been resolved differently if it involved the filing of an income tax return. Rohrabaugh, 611 F. 2d at 214. In the present case, the amount of education that the taxpayer received is unclear, the taxpayer is experienced in business matters, and she claims to have relied on an accountant who was giving her conflicting advice. In addition, this case concerns ROT liability, some of which the taxpayer paid whenever a field auditor visited her business. She was, therefore, aware of her potential liability and did not seek additional advice to determine it. As previously stated, these facts do not warrant a finding that the failure to file and pay the liability was due to reasonable cause.

Recommendation:

For the foregoing reasons, it is recommended that the taxes and penalties be upheld.

Linda Olivero
Administrative Law Judge

Enter: August 31, 2006